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HOUSE ARMED SERVICES COMMITTEE
HOUSE OF REPRESENTATIVES

STATEMENT BY
HONORABLE SEAN O'KEEFE
COMPTROLLER OF THE DEPARTMENT OF DEFENSE

BEFORE

HOUSE ARMED SERVICES COMMITTEE
SUBCOMMITTEE ON READINESS

IMPROVING FINANCIAL MANAGEMENT
THE DEPARTMENT OF DEFENSE

MARCH 8, 1990

Mr. Chairman and members of the committee,

I am pleased to be before the Committee today to discuss the Department's financial management systems.

A recent GAO report on Air Force financial management operations suggests that our controls over property and inventory assets, financial statement adjustments and reporting in our accounting systems is inadequate. I'd like to address these concerns within the context of our Defense Management Report (DMR) initiatives which specifically focus on the trouble areas identified by GAO.

Before we begin, I'd like to comment on one point that has been raised as a result of the GAO report. There is a media perception that the GAO report shows that the Air Force and the DoD have inaccurately reported the cost of DoD weapons systems to the Congress and to the public. It is clear that the financial statement records examined by GAO did not agree with the budgetary data provided to Congress. However, we feel confident that the budgetary data provided to Congress have been accurate because it is specifically collected from numerous financial sources for reporting in the Selected Acquisition Reports (SARs) to verify appropriated levels and budget planning. The GAO acknowledges, the data reported on SARs are accurate. Moreover, GAO concluded that our funds control procedures assured that spending limits are not exceeded and this system is working effectively.

In short, we manage funds by appropriation account as approved by Congress. GAO's concern is that the data does not easily translate discretely as expense or asset data to form the basis of a financial statement comparable to private-sector practice. The does not indicate inaccurate accounting of appropriated dollars.

Nevertheless, this does not lessen the need to make all our accounting and financial documents whole and consistent throughout the Department. When we achieve this objective, an additional benefit derived will be to translate data in the form GAO desires. Let me describe how several of the initiatives we have begun over the last couple of months are aimed at the issues identified in the GAO report.

DOUBLE ENTRY BOOKKEEPING

GAO criticized the absence of a double entry bookkeeping system. This tool is an absolute requirement in the private sector; however, it is not as widely employed in the public sector. In the Government, the establishment of a double-entry system requires the use of the governmentwide standard general ledger advocated by OMB and the Treasury Department. Our DoD-wide single integrated accounting system initiative, which just started as part of the DMR effort on Corporate Information Management, will incorporate this governmentwide standard general ledger and chart of accounts. The system will also comply with standard accrual requirements, record actual costs and provide cost visibility on a consistent basis throughout the

Department. Furthermore, the system will preclude arbitrary or unsupported adjustments of the kind found by GAO in the Air Force.

In essence we intend to integrate our management information systems to control funds by appropriation account and display the data consistently in financial statements.

PROPERTY AND INVENTORY ACCOUNTING

The GAO also faults the Air Force because it did not properly account for or control physical assets. This has been another longstanding problem throughout the Department. Our DMR initiative on the development of standard systems will assure control of these assets from acquisition to consumption, or to disposal, and will track the assets at every level. This will be done both through a standard financial accounting system and through an integrated materiel management system which will provide source data for the accounting system.

GOVERNMENT FURNISHED MATERIAL

The GAO also reported that Air Force property systems do not track military hardware, or government-owned material in the hands of contractors. This problem has also been long known and, prior to the DMR effort, no effective solution had been attempted. However, as part of DMR we have decided that complete accounting control will be established over all government material, or other government property, in the hands of contractors. This effort is a part of the single accounting

initiative and will be integrated with the initiative for a DoD-wide materiel management system. The net result will be that DoD will account for and have control over material in the hands of government contractors at all times.

Each of these initiatives are displayed in the fiscal year 1991 budget request.

Mr. Chairman, I also know that the GAO plans to do similar audits in the Army and Navy to determine the extent of the problems in those accounting systems. Because we believe that the GAO will find many of the same conditions in these other Military Departments, the Deputy Secretary does not want to wait for the GAO reports to identify for us other issues which may need to be acted upon above and beyond those I have outlined. Therefore, he has directed me to review the state of DoD accounting systems. By May 1, 1990, I am to report to him my recommendations as to additional actions, or accelerated actions that may need to be taken to address both DoD concerns and the concerns of the Congress.

We need to do these self-appraisals now because there are many more initiatives being worked than the ones I just covered. Many of our DMR actions require an overall vision since they involve DoD-wide changes to our entire management and system process. My review will cover these areas over the next two months.

DEFENSE MANAGEMENT REPORT

Let me update the Committee on some of the primary actions launched by Deputy Secretary Atwood as critical reform efforts within the DMR. In looking at requirements across DoD, the Deputy Secretary identified redundant, Service unique systems and operations lacking overall integration. To address this disparate system, he devised the Corporate Information Management (CIM) initiative to integrate the data flow within common functional areas. DMR and Corporate Information Management initiatives are changing management techniques and structures, as well as information system integration perspectives and requirements. These initiatives will change the supply, inventory and accounting process and create design requirements for new DoD-wide integrated systems with common approaches in seven initial functional areas (chart 1). A CIM Task Force has organized the effort and an Executive Level Group from industry and government is critiquing our program direction. Representatives from each Military Department and the defense agencies are working in functional groups to achieve these objectives. The initiatives and their starting dates (chart 2) are:

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|---|------------------------------|
| • Distribution Centers (12/89) | • Materiel Management (4/90) |
| • Civilian Payroll (12/89) | • Contract Payment (4/90) |
| • Government Furnished
Material (2/90) | • Civilian Personnel (4/90) |
| • Financial Operations (3/90) | • Medical (4/90) |

These efforts are intended to eliminate separate Service systems and provide integrated systems that can relate to each other, as well as across all of DoD (chart 3). The systems will provide management at every level with useful and timely information. Contract data will integrate with fund controls, contractor material requisitions, delivered items and warehouse stocks, as well as payment and accounting requirements.

DMR Initiatives and Savings - Our latest calculations of potential savings from the four initiatives classified as financial improvements indicates almost a 6 to 1 payback over five years. Briefly, the initiatives and their net returns (chart 4) are:

	(\$ IN MILLIONS)
Standard ADP System	\$2,178
Computer Aided Logistics Support	\$2,165
Stock Funding of Reparables	\$2,142
Accounting for Government Furnished Material	375

On an investment of \$1.6 billion, we have gross savings of \$8.4 billion. Most importantly, the savings have been deleted from our budget request for fiscal year 1991 and our outyear plans. The budgetary incentive to make the initiatives work is significant.

Consolidation Studies are underway to eliminate unnecessary organizational layers and non-value added functions to streamline the process. Reports on seven initial studies will be delivered to Deputy Secretary Atwood by May 1, 1990. These studies will review consolidation and cost reduction proposals

most important, the Deputy Secretary expects detailed implementation plans for:

- Supply Depots
- Inventory Control Points
- Aeronautical Maintenance Depots
- Accounting and Finance Centers
- Other Maintenance Depots
- R&D Laboratories
- ADP Operations and Design Centers

As listed on the chart (chart 4) the consolidations involving the Accounting and Finance Centers and the ADP Operations are most pertinent to the focus of this hearing. Our actions are designed to solve some of the concerns raised in current, as well as earlier GAO reports. But, our primary incentive is we believe that streamlining and reducing the number of sites charged with keeping the books for DoD could provide better accounting discipline, as well as save money. In short, Deputy Secretary Atwood will give these initiatives a great deal of attention.

I hope I have conveyed to the Committee that an efficient and effective financial management system is a primary objective of the DoD. A large organization like the Department of Defense must have effective financial controls. The basic accounting controls in DoD should be up to the standard of those found in most large private-sector organizations and we must control funds as appropriated by Congress.

The management reform commitments made by Secretary Cheney and Deputy Secretary Atwood are being actively worked and will be brought on line and on time. I fully appreciate that you have heard this song before, that similar promises in the past

have not materialized and that a whole new set of initiatives usually replace the prior set when the Administration changes. However, I see two conditions that will allow such changes and, in fact, force them. The continuing decline in resources and the advances in technology are converging realities. The level of appropriated resources will propel the efficiency and effectiveness which technology can now deliver at a reasonable price. We're actively beginning these efforts as displayed in the fiscal year 1991 budget

SUMMARY

I assure you Mr. Chairman and members of the committee that the initiatives I have just outlined for financial management go to the heart of the problems found by GAO. DoD needs a standardized and consolidated accounting system under general ledger control where all property and inventory account values can be reconciled to physical counts of property, materials and supplies and discrepancies can be investigated and documented. DoD financial statements must not only record our budgetary control over funds appropriated to us but also accurately and reliably record our stewardship over all assets and resources entrusted to our care and control. Finally, information required by Congress for weapon systems costs must tie into all our accounting records. The Department is committed to achieving this goal.

As you can see, we have designed specific initiatives in relation to identified problems which we've been working on

since the President tasked us with the management review last year. The Secretary of Defense fully appreciates your concerns and constructive recommendations and will factor them into our implementation plans at every opportunity.

I believe that we have accomplished a great deal in the last year. But, DoD can do much more to improve the management of our nation's defenses. We could accomplish far more still with the assistance of Congress.

Mr. Chairman this concludes my prepared statement. Derek Vander Schaaf and Alvin Tucker are here with me. We will be pleased to answer any questions from you and other Committee members.